REPUBLIC OF SLOVENIA
FISCAL COUNCIL

Assessment by the Fiscal Council: Compliance of the Proposal of Revised State Budget 2019 with the fiscal rules

February 2019

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The assessment is based on the Proposal of Revised Budget of the Republic of Slovenia for 2019 and the updated Draft Budgetary Plan 2019, which were received by the Fiscal Council on 25 January 2019. Some forecast values in EUR are calculated indirectly from shares in GDP, which are included in the updated Draft Budgetary Plan 2019, consequently numbers do not necessarily add up. Cut-off date: 31 January 2019.

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EXECUTIVE SUMMARY

The proposal of revised state budget and the Framework for the Preparation of the General Government Budget indicate an expansive and pro-cyclical fiscal policy in 2019. In the Fiscal Council's opinion, this policy is unsuitable under the current circumstances. According to the estimates of the Fiscal Council and the Government of the Republic of Slovenia, the fiscal situation will this year deteriorate in the environment of expected persistently favourable economic conditions. The implementation of a procyclical policy means missing the opportunity to create sufficient space for manoeuvre in times of prosperity to mitigate the negative consequences of the economy's cooling in the future. At the same time, Slovenia is returning to a situation in which a renewed fiscal effort will be required to structurally balance public finances.

In the current situation, fiscal rules do not require decreasing expenditure, but only a restriction on their rapid growth. A sufficient nominal surplus should be created to maintain the structural balance of the general government, which has been achieved over the past two years. According to the submitted budget documents, the Government of the Republic of Slovenia expects an increase in general government expenditure by EUR 1.13 billion compared to 2018. Such a level of expenditure, in the opinion of the Fiscal Council, is determined in contravention to legislation. According to the proposal of revised budget, the bulk of the increase in expenditure is the result of higher costs of labour. Expenditure on investment and subsidies are also planned to substantially increase, partly also in conjunction with relatively optimistic assumptions regarding the drawdown of the EU funding.

The law requires the Fiscal Council to assess the appropriateness of the anticipated total expenditure level and general government balance and not to determine the structure of budget revenues and expenditures, which is the responsibility of the Government. The provisions of the Fiscal Rules Act would be respected if the overall general government expenditure were increased in 2019 by approximately EUR 870 million, which would, with the exception of last year, be the highest growth in expenditure after 2009. This increase would fall short of the one anticipated by the adopted Framework by approximately EUR 270 million. The Fiscal Council assesses that an increase in expenditure, harmonised with fiscal rules, would not limit the Government's ability to pursue its objectives of promoting long-term economic growth and redistributing income, but would enable the Government to achieve its objectives without endangering medium-term fiscal sustainability and thus the population's long-term well-being.

Recent months have seen increased risk of a more severe slowdown in 2019's economic growth than was forecast in projections that served as a basis for the budget documents. In an uncertain environment, the Government should follow the precautionary principle in planning both public revenue and expenditure. With regard to the high increase in revenue which is mainly a result of economic growth, the proposed budget documents anticipate a permanent increase in expenditure without addressing long-term challenges.

This year, public debt is expected to continue to decline and about half of the reduction in the public debt-to-GDP ratio is expected to be contributed by the projected growth in the nominal GDP and, to a significant extent, also by revenues from privatisation. Despite a decrease in recent years, public debt has remained high and its increase is one of the of the highest in the EU compared to the pre-crisis level. As a result, the interest expenditure level will still exceed that of 2008 by approximately

EUR 400 million despite the continued decrease. The Fiscal Council believes that the current debt reduction is not in itself a sufficient condition to ensure sustainable public finances in the long run, whereas structurally sustainable public finances are a necessary condition for debt reduction in the long term.

Budget documents are adopted outside the statutory time limits, which is understandable due to the formation of the new government last autumn. However, the Fiscal Council believes that the process of preparing budget documents again does not reflect the legal requirement for synchronising their adoption and medium-term fiscal policy planning. Although the Fiscal Rule Act requires a simultaneous adoption of amendments to the Framework and of the state budget, the proposal of revised state budget was submitted only more than one month after the adoption of the amendments to the Framework by the National Assembly of the Republic of Slovenia. Moreover, the proposal of revised state budget to a certain extent deviates from the adopted Framework. Furthermore, the Framework has been amended again for one year only, although the law requires a comprehensive revision for the current and the following three years. In the opinion of the Fiscal Council, this is particularly problematic because following the formation of the government, measures were taken with fiscal consequences for the coming years. In the persistent absence of medium-term budget planning the aforementioned deviation from the structural balance gives rise to doubts about the ability to achieve medium-term fiscal sustainability. The Fiscal Council therefore expects the Government to present credible and comprehensive budgetary plans leading to medium term fiscal sustainability in the context of the preparation of the Stability Programme and the National Reform Programme in spring 2019.

Legislative framework

On 25 January 2019 the Fiscal Council received the Proposal of Revised Budget of the Republic of Slovenia for 2019 from the Ministry of Finance. According to Article 148 of the Constitution of the Republic of Slovenia, revenues and expenditures of budgets must be balanced in the medium term without borrowing, or revenues must exceed expenditures. The method and the timeline for the implementation of the rule are laid down by the Fiscal Rule Act (ZFisP). Pursuant to paragraph two of Article 7 of ZFisP, the Fiscal Council is obliged to make an assessment of compliance with the fiscal rules on the basis of a proposal of revised state budget submitted by the Government to the National Assembly of the Republic of Slovenia for adoption. Pursuant to paragraph one of Article 9f of the Act Amending the Public Finance Act (ZJF-H), the Fiscal Council must assess the proposal of revised budget within fifteen days of receipt thereof.

Pursuant to paragraph six of Article 6 of the ZFisP, the National Assembly and the Fiscal Council should, in addition to the amendments to the state budget, be sent a proposal for amending the Framework for Drafting General Government Budgets and the National Assembly should adopt both documents simultaneously. Contrary to this legal requirement, on 6 December 2018 the Government of the Republic of Slovenia sent to the Fiscal Council for assessment a proposal for the Ordinance Amending the Ordinance on the framework for Preparing the General Government Budgets for the 2018–2020 Period (Framework). The Framework was adopted by the National Assembly on 21 December 2018 despite the Fiscal Council's negative opinion based on the provisions of the ZFisP. Pursuant to paragraph two of Article 9g of the ZJF-H, amendments to the Framework and to the budget must be mutually consistent.

Pursuant to Articles 3 and 15 of the ZFisP, the Fiscal Council monitors compliance with the fiscal rules for the general government sector in accordance with the European System of Accounts methodology (ESA, 2010). The state budget is the largest unit, but still only slightly more than one-third of the general government sector, and is thus, like other public finance budgets (social protection systems, local communities) prepared according to the methodology of the International Monetary Fund for monitoring government financial statistics (GFS) based on the cash flow principle.[1] The Government must ensure compliance with the fiscal rules applicable to the general government sector in accordance with a combination of public finance budgets and institutional unit items that constitute the general government sector. Due to the different methodologies and the several public finance budgets and institutional units that constitute the general government sector, the assessment of the projected state budget trends thus only supplements the assessment of compliance with the fiscal rules applicable to the general government sector. In this regard, the Fiscal Council is focused on assessing the consistency of the main state budget aggregates with the Framework and on analysing the projected revenues and expenditures in the proposal of revised state budget. The purpose of this assessment is to (i) verify the consistency of the proposal of revised state budget with the adopted Framework; (ii) sum up the main conclusions regarding compliance with the fiscal rules applicable to the general government sector based on the December amendment to the Framework[2]; and (iii) assess the reality of the revenues and expenditures projected in the proposal of revised state budget.

[1] The structure of the general government sector is available at: http://www.mf.gov.si/en/areas_of_work/general_government_finance/public_finances/general_goverment_sector/.

[2] Assessment by the Fiscal Council: Proposal for the Ordinance amending the Ordinance on the Framework for Preparing General Government Budgets for the period 2018–2020, December 2018 (http://www.fs-rs.si/opinion-of-the-fiscal-council-proposal-for-the-ordinance-amending-the-ordinance-on-the-framework-for-preparing-general-government-budgets-for-the-period-2018-2020/).

1. Consistency of the proposal of revised state budget with the adopted Framework

The proposal of revised state budget is not fully consistent with the Framework which was adopted in December last year; at the same time, both the Framework and the proposal of revised budget are not consistent with the statutory fiscal rules. The government prepared the proposal for amendments to the Framework more than one month before submitting the proposal of revised budget. The Fiscal Council has established that the level of expenditure shown in the proposal of revised budget is consistent with, while the target balance surplus exceeds the level determined by the December Framework by 0.1% of GDP. The same also applies to the general government sector, for which the targets are set out in the amended Draft Budgetary Plan, and the surplus is higher by 0.15% of GDP. The higher surpluses are, along with the projected unchanged expenditure level, the result of higher projected revenues. In the proposal of revised budget and in the amended Draft Budgetary Plan they are approximately EUR 50 million and EUR 75 million respectively higher than implicitly projected by the adopted Framework. Although the Fiscal Council had established that the Framework did not respect the fiscal rules, the Framework was nevertheless approved by the National Assembly of the Republic of Slovenia on 21 December 2018.

Table 1.1: Comparison of MoF public finance forecasts - Framework (December 2018), DBP 19 and revised state budget 2019 (January 2019)

EUR million	2019					
	General Government			State budget		
	Framework (Dec.18)	DPB 19 (Jan.19)	*diff.*	Framework (Dec.18)	Revised (Jan.19)	*diff.*
Revenues	20,803	20,877	*75*	10,306	10,354	*48*
Expenditures	20,610	20,610	*0*	10,160	10,160	*0*
Balance	193	267	*75*	146	194	*48*
Balance (in % of GDP)	0.40	0.55	*0.15*	0.30	0.40	*0.10*
Gross debt (in % of GDP)	66.6	66.0	*-0.6*	n.a.	n.a.	*n.a.*

Source: MoF, FC calculations

Table 1.2: Compliance with fiscal rules - comparison of assessments (December 2018 and February 2019)

	2019		
	Framework (Dec.18)	DBP 19 (Jan.19)	*diff.*
Structural balance (in % of GDP)	-0.6	-0.4	*0.2*
Change in the structural balance (in % of BDP)	-0.7	-0.6	*0.1*
Growth in net expenditure - nominal (in %)	4.1	4.2	*0.1*
Reference rate to be applied - nominal (in %)	3.5	3.5	*0.0*
Level of general government expenditure - MoF projection (EUR million)	20,610	20,610	*0*
Maximum level of general government expenditure - FC (EUR million)	20,343	20,343	*0*
difference	*267*	*267*	*0*
General government gross debt (in % of GDP)	66.6	66.0	*-0.6*

Source: MoF, FC calculations

We hereby resume and update the assessment of compliance with fiscal rules on the basis of the adopted Framework and the proposed Draft Budgetary Plan for 2019 for the general government sector as a whole, which was published by the Fiscal Council on 13 December 2018.[3] The Fiscal Council notes that the statutory ceiling of the general government expenditure is the one specified in the already adopted Framework. The Draft Budgetary Plan is only a document which the Government has a duty to prepare in the framework of public finance governance in the EU. The Fiscal Council requires some of its elements in order to make an assessment of fiscal rule compliance. At the same time, the Fiscal Council calls attention to the lack of transparency in adopting budget documents, which is this time due to non-compliance with the statutory provisions on the time-consistency regarding the preparation and adoption of amendments to the Framework and amendments to the state budget.

[3] Assessment by the Fiscal Council: Proposal for the Ordinance amending the Ordinance on the Framework for Preparing General Government Budgets for the period 2018–2020, December 2018 (http://www.fs-rs.si/opinion-of-the-fiscal-council-proposal-for-the-ordinance-amending-the-ordinance-on-the-framework-for-preparing-general-government-budgets-for-the-period-2018-2020/).

2. Compliance with fiscal rules

In a period of favourable economic conditions since 2014, the fiscal situation has improved, and, in the period 2017-2018, the general government balance was structurally balanced. In the period 2014-2018, Slovenia had one of the highest economic growth rates in the EU, and nominal GDP increased by one-fourth or EUR 9.5 billion.[4] These favourable economic conditions represented a very good opportunity to consolidate public finance. The nominal general government balance thus changed from a deficit of 5.5% of GDP in 2014 to a projected surplus of 0.8% of GDP by 2018.[5] According to the current Fiscal Council's estimate, the general government balance in the period 2017-2018 was also structurally balanced, by which a medium-term objective was achieved.[6] In this regard it should be noted that consolidation was not carried out in a systematic and sustainable manner, but primarily through gradual relaxation of anti-crisis measures adopted in 2012 and 2013. The current Government also agrees with such an assessment.[7]

The proposed budget documents for 2019 point to expansionary fiscal policy which is inappropriate in the current situation and which, if the favourable economic conditions continue, could lead to an unnecessary structural deterioration in public finance. The amended Framework projects a nominal public sector surplus of 0.55% of GDP for 2019, which is less than in the previous year. Despite the anticipated slowdown in economic growth the situation will remain favourable and the forecast economic growth will exceed the current estimated potential growth level in 2019 as well. Such conditions constitute an appropriate basis for the preparation and adoption of measures for a sustainable improvement of public finance. On the contrary, the proposed budget documents indicate an expansionary fiscal policy and a deterioration in the structural balance. According to the estimate of the Fiscal Council and of the Government of the Republic of Slovenia, the structural balance could again deteriorate into a deficit of 0.4% of GDP.[8] Not achieving the medium-term fiscal objective is unacceptable in terms of needing to implement a countercyclical fiscal policy and forces Slovenia into a position, where it will again be necessary to achieve a relatively high fiscal effort to balance the structural part of public finance. The implementation of a procyclical policy means missing the opportunity to create sufficient space for manoeuvre in times of prosperity to mitigate the negative consequences of the economy's cooling in the future.

The Fiscal Council notes that compliance with statutory fiscal rules in current situation would not require decreasing expenditure but rather restricting their growth by creating a sufficient nominal surplus while maintaining the structural balance of the general government sector. According to

[4] The average annual real GDP growth rate in Slovenia in the period 2014-2018 was 3.6% (for 2018, average data for the first three quarters were taken into account), the fifth largest growth rate in the EU. The average economic growth rate for the euro-area Member States was 2.0% in the same period.

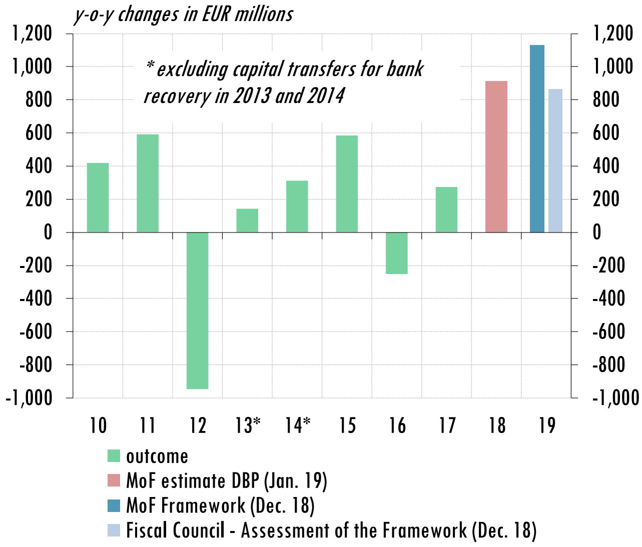
[5] The first official estimate of the general government balance for 2018 will be known at the end of March 2019, when the assessment of the main general government aggregates for the last quarter of 2018 will be published by the Statistical Office of the Republic of Slovenia.

[6] The medium-term objective for Slovenia is currently a general government structural surplus of 0.25% of GDP, with a permissible tolerance of 0.25% of GDP. In accordance with Article 15 of the ZFisP, in the period when Slovenia is approaching its medium-term fiscal objective, general government budgets are deemed balanced in the medium term if the structural balance of the general government approaches the medium-term fiscal objective in accordance with the dynamics determined on the basis of the Stability and Growth Pact. The European Commission sets a new medium-term fiscal objective every three years, one year after the publication of the Ageing Report. A new medium-term fiscal objective will be set in spring this year. On the basis of the available data, the Fiscal Council believes that it will probably be lower than the current objective.

[7] The position of the Government of the Republic of Slovenia on the Fiscal Council's Assessment of the Consistency of the Ordinance Amending the Ordinance on the Framework for Preparing General Government Budgets for the Period 2018–2020 with the fiscal rules, pp. 8 and 10.
Available in Slovene at: http://www.vlada.si/delo_vlade/gradiva_v_obravnavi/gradivo_v_obravnavi/?tx_govpapers_pi1%5Bsingle%5D=%2FMANDAT18%
2FVLADNAGRADIVA.NSF%2F18a6b9887c33a0bdc12570e50034eb54%2Fa1729097d702ed71c1258363003588b3%3FOpenDocument&cHash=c811fb4d39f238abce5280eb2cb34c8d

[8] With regard to the estimated structural balance for 2018, this level of deterioration could still be consistent with the rule according to which a two-year average structural effort (-0.2 percentage points) should not deviate from the required (0.0 percentage point) on average by more than 0.35 percentage points.

Figure 2.1: General government expenditures



Sources: SORS, MoF DBP 19 (Jan. 19), MoF Framework (Dec. 18), FC Assessment of the Framework (Dec. 18).

the adopted Framework and the amended Draft Budgetary Plan, the maximum amount of the general government sector expenditure for 2019 is EUR 20,610 million. In accordance with Article 3 of the ZFisP the expenditure ceiling is determined with regard to the established cyclical position of the economy and the expected revenue level. In the Fiscal Council's estimate, the increase in expenditure, which is in conformity with the statutory fiscal rule, should be about EUR 270 million less than forecast by the adopted Framework or the amended Draft Budgetary Plan. This would still be a considerable increase in fiscal expenditure since it could total about EUR 870 million or 4.4% (instead or more than EUR 1.1 billion or 5.8%, as anticipated by the adopted Framework) compared with the estimate for 2018. This would be, at the same time, the highest growth in general government expenditure since 2009 (with the exception of the previous year). The Fiscal Council assesses that an increase in

Table 2.1: Calculation of maximum level of general government expenditure based on ZFisP

			2018 estimate DBP (Jan.19)	2019 Framework (Dec.18)
Revenues (MoF)	*% of GDP*		43.42	42.87
Revenues (MoF)	*EUR million*	R	19,861	20,804
GDP (IMAD)	*EUR million*	Y	45,742	48,529
Output gap (FC)	*% of potential GDP*	OG	1.6	2.1
Potential output (FC)	*EUR million*	YP	45,022	47,511
Elasticity of the balance to the output gap		á	0.477	0.477
One-offs (MoF)	*% of GDP*	o	-0.09	-0.05
Expenditures (MoF)	*% of GDP*		42.58	42.47
Expenditures (MoF)	*EUR million*	E_MF	19,477	20,610
Maximum expenditure (FC estimate)	***EUR million***	**E**		**20,343**
Difference	*EUR million*	E 2019 - E_MF 2019		-267
Difference 2019-2018	*EUR million*	E 2019 - E_MF 2018		866

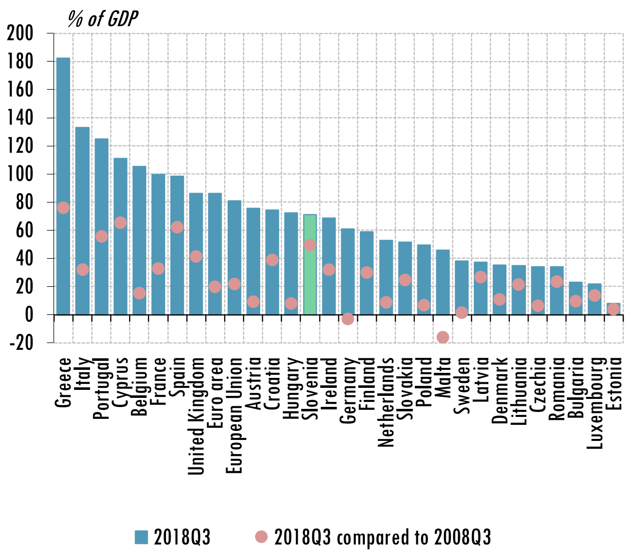
Note: Symbols in the table correspond to the symbols in the mathematical formula for calculation of the maximum level of expenditures of the general government sector in paragraph 4 of Article 3 of the Fiscal Rule Act (ZFisP).
Sources: MoF, IMAD, FC calculations.

expenditure, harmonised with fiscal rules, would not limit the Government's ability to pursue its objectives of promoting long-term economic growth and redistributing income, but would enable the Government to achieve its objectives without endangering medium-term fiscal sustainability and thus the population's long-term well-being.

The proposed budget documents relate to 2019 and once again do not reflect the statutory requirement for a medium-term oriented fiscal policy. Amendments to the adopted Framework relate only to this year, despite the fact the paragraph one of Article 6 of the ZFisP determines that the Framework should be adopted for at least the current and the next three years. The Framework is adopted outside the statutory autumn time limit, which is understandable due to the formation of the new government. It should be noted however that measures adopted after the formation of the new government will have fiscal consequences in the following years. As a result, comprehensive amendments to the Framework are required since only such Framework could pave the way for a medium-term oriented fiscal policy. The same applies to the state budget since the budget for 2020 was not adopted in 2018. In this regard, the Fiscal Council notes that compliance with the precautionary principle referred to in Article 4 of the ZFisP does not relieve the Government from planning a medium-term fiscal policy. The precautionary principle requires taking into account the risks associated with economic growth in the planning of both fiscal revenues and expenditures and does not relate to the uncertainties in forecasting macroeconomic aggregates. In this regard, the Fiscal Council considers it worrying that the high growth in revenue, achieved mainly through economic growth, will be accompanied by a permanent increase in expenditure, which will not simultaneously address structural challenges of public finances. Moreover, the anticipated decrease in interest expenditure will continue to play an important role in restraining the increase in total expenditure, while the increase in general government primary expenditure (excluding interest expenditure) will further intensify this year.

Public debt is expected to decrease this year to 66% of GDP, of which more than one half is expected to result from the nominal GDP increase. The anticipated decrease in public debt will be in compliance with the Stability and Growth Pact rules. According to the Government, a decrease in

Figure 2.2: General government consolidated debt



Source: Eurostat, FC calculations.

public debt is the guiding principle in devising economic policies, followed by fiscal sustainability.[9] The Fiscal Council notes that the two objectives are not mutually exclusive but complementary. While sustainable or structurally balanced public finance constitute an essential condition for reducing the debt in a long-term, the current debt reduction is not in itself a sufficient condition to ensure sustainable public finances, independent from the economic cycle, in the long run. This also applies to Slovenia where, in recent years, the decrease in the share of public debt in GDP has been particularly brought about by favourable economic conditions and the primary surplus of the general government balance, which is cyclical to a large extent. 2019 will see a continued decrease in the contribution of interest expenditure to the general government debt. With regard to the estimated debt developments, its active management in the past few years should be highlighted, as it contributed to the extension of the duration to maturity, a higher diversification of individual debt instruments, and a decrease in the US dollar-denominated debt share. The debt level has remained high despite a decrease since 2015. Only four EU Member States recorded a debt increase which was higher compared to the 2008 pre-crisis level than Slovenia.[10] As a result, interest expenditure level will still be twice, i.e. EUR 400 million higher than that in 2008.

[9] The position of the Government of the Republic of Slovenia on the Fiscal Council's Assessment of the Consistency of the Ordinance Amending the Ordinance on the Framework for Preparing General Government Budgets for the Period 2018–2020 with the fiscal rules, p. 6.
Available in Slovene at: http://www.vlada.si/delo_vlade/gradiva_v_obravnavi/gradivo_v_obravnavi/?tx_govpapers_pi1%5Bsingle%5D=%2FMANDAT18%2FVLADNAGRADIVA.NSF%2F18a6b9887c33a0bdc12570e50034eb54%2Fa1729097d702ed71c1258363003588b3%3FOpenDocument&cHash=c811fb4d39f238abce5280eb2cb34c8d

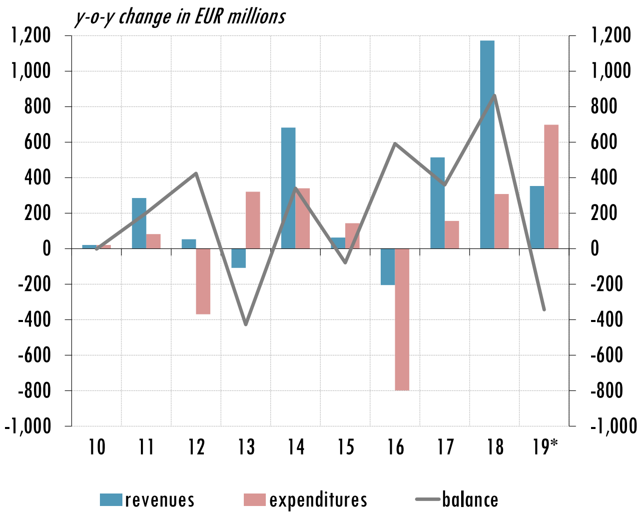
[10] At the end of the third quarter of 2018 (the latest available data for the entire EU), there were 16 EU Member States with a lower share of general government debt in GDP than Slovenia, and in 14 EU Member States it was below the Maastricht reference value of 60%.

3. Assessment of the projected revenues and expenditures in the proposal of revised budget

According to the proposal of revised state budget, a surplus of EUR 194 million or 0.4% of GDP is forecast for this year. Revenue growth is forecast to slow down to 3.5%, while expenditure growth will strengthen substantially to 7.4%. The surplus is expected to be EUR 343 million lower than in the previous year when it totalled EUR 537 million or 1.2% of GDP.[11] The anticipated lower economic growth will entail a slower growth in revenues that largely depend on economic and labour market conditions. On the expenditure side, the anticipated increase is to a large extent permanent as a result of the arrangements and adopted measures and is particularly due to the higher costs of labour in the public sector. Moreover, a significant part of the forecast increase in total revenue depends on the effective drawdown of the EU funds, which has so far rarely reached the targets projected on the adoption of budget documents. On the expenditure side, this can primarily be reflected in lower than anticipated investment expenditure. This could also result in a lower fiscal policy impact on the strengthening of the long-term economic potential.

The growth of state budget revenue is expected to slow down in 2019 and will be to a large extent based on a relatively optimistic assumption of effective drawdown of EU funds. The growth of state budget revenue is projected at EUR 353 million or 3.5% above the previous year's level, which is considerably lower growth than in the previous two years. The increase in the most significant tax revenues (VAT, personal income tax and corporate tax) will slow down in line with the anticipated development of tax bases, as shown in the last year's forecast by IMAD, which forms the basis of the proposal of state budget. A slight decline in revenue from excise duties is expected this year as well. Decreased total revenue growth will be largely due to lower non-tax revenues. This is the result of the high growth in the previous year when dividend payment of Nova Ljubljanska banka included the amount of retained earnings from previous years and is also the result of the fact that this year

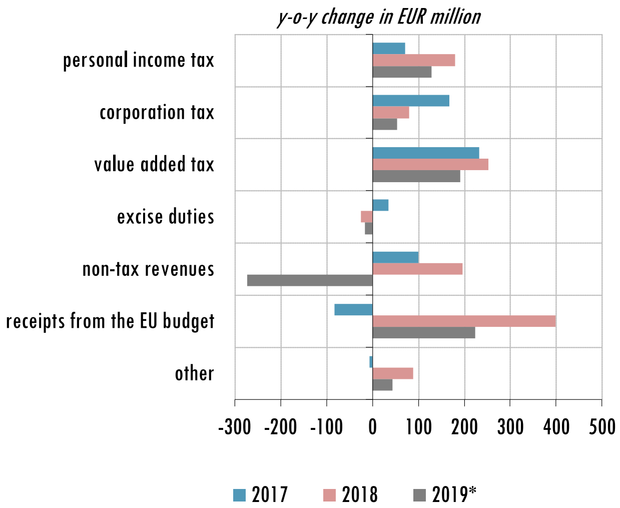
Figure 3.1: State budget revenues and expenditures



*Source: MoF, FC calculations. *Proposal of revised state budget RS 2019 (Jan.2019).*

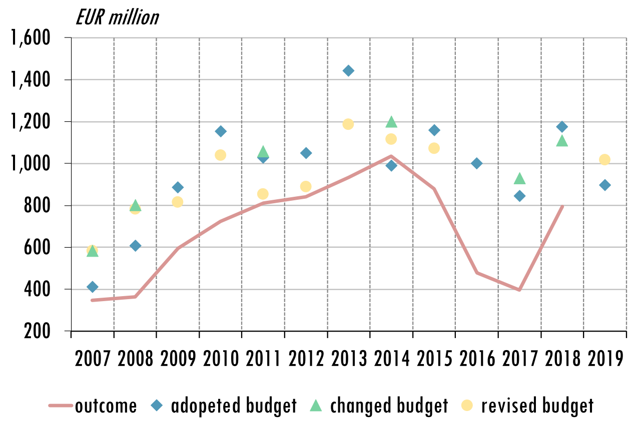
[11] In this regard it should be noted that last year's surplus was to a great extent the result of two one-off events not associated with actual trends. In 2018, EUR 208 million of EU funds from the previous financial perspective were paid into the state budget, and EUR 271 million dividends from profits generated by Nova Ljubljanska banka also comprised EUR 189 million of retained profits from the previous year. Without taking into account these two factors, the state budget surplus would be only EUR 140 million (only retained profits for 2017 were deducted from Nova Ljubljanska banka's dividends).

Figure 3.2: State budget revenues



*Source: MoF, FC calculations. *Proposal of revised state budget RS 2019 (Jan.2019).*

Figure 3.3: Receipts from the EU budget

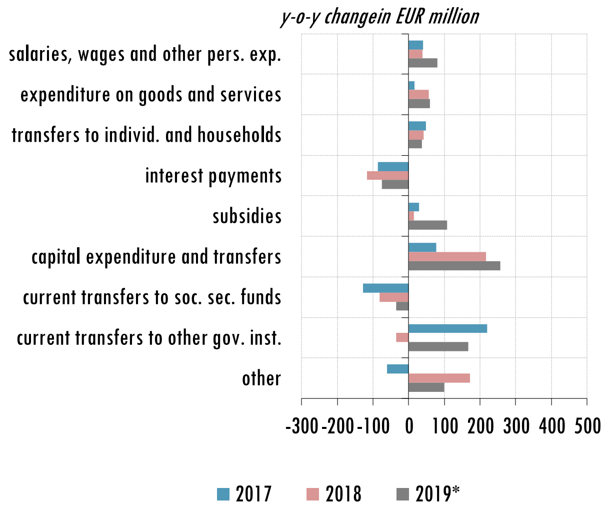


Note: Markers for "revised budget", "changed budget" and "adopted budget" refer to specific budget documents for a specific year. For example, marker "revised budget" in 2015 refers to "78 Receipts from the EU budget" in the revised budget for 2015. There were no revised budgets for 2016, 2017 in 2018 , therefore no marker "revised budget" is shown for those years.
Sources: MoF, FC calculations.

dividend will be lower on account of the sale of the government's significant equity interest in the bank. The key assumption for the projected revenue growth is the drawing on EU funds in excess of EUR 1 billion. Since EUR 208 million were paid into the state budget last year from the previous financial perspective, the funds drawn under the current financial perspective are expected to increase this year by EUR 430 million or approximately 75%. This is an optimistic assumption given the possibility of continued difficulties with the drawing of funds and the past experiences with the actual outcome (Figure 3.3).

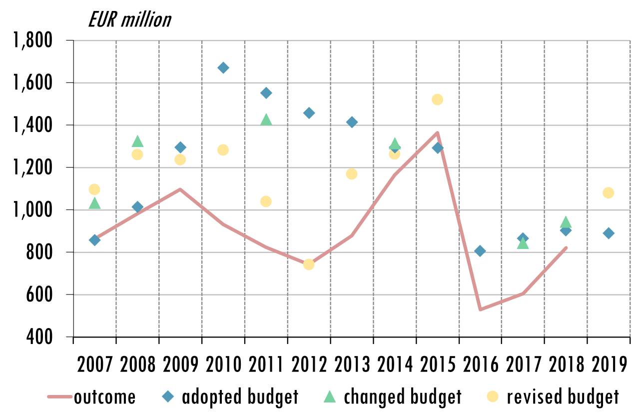
This year the growth of state budget expenditure will be much stronger primarily on account of the agreed increase in labour costs. After a 3.4% increase in the previous year, expenditures are expected to increase this year by nearly EUR 700 million or 7.4%. Only a bit less than one half of the anticipated increase will be the result of higher labour costs which will increase by approximately EUR

Figure 3.4: State budget expenditures



*Source: MoF, FC calculations. *Proposal of revised state budget RS 2019 (Jan.2019).*

Figure 3.5: Capital expenditure and transfers



Note: Markers for "revised budget", "changed budget" and "adopted budget" refer to specific budget documents for a specific year. For example, marker "revised budget" in 2015 refers to "42 Capital expenditure" and "43 Capital transfers" in the revised budget for 2015. There were no revised budgets for 2016, 2017 in 2018 , therefore no marker "revised budget" is shown for those years.
Source: MoF, FC calculations.

300 million on the previous year.[12] Investment expenditure and transfers are expected to increase to a similar extent as last year by more than 30%. We consider that a significant part of the increase in this expenditure will depend on the successful drawdown of EU funds, so that, like in the previous years, the final achievement could fall short of the projected level. The total increase in expenditure will also be due to a large extent to subsidies which are expected to increase by EUR 108 million or 27.2%. The high increase in expenditure on goods and services (7.7%) is expected to continue. Almost one-half of the increase will be due to higher expenditure on military equipment. Transfers to individuals and households will increase less than in the previous year (by EUR 36 million or 2.8%). The continued favourable labour market conditions will contribute to lower unemployment compensation, while due to the adopted measures there will be an increase in expenditure on social assistance benefits in cash, state scholarships and care for mentally and physically handicapped persons. Transfers to the pension fund will decrease this year as well (-3.5%), but much less than in the previous four years when it decreased on average by 10.3 percent each year. Alongside the continued increase in employment and wages, the pension fund income will continue to be high this year, but the decrease in the appropriate transfer from the state budget will be lower due to an increase in pensions. Interest payments will decrease again this year by about one-tenth. This points to a continued importance of the role of the assumption of the persistently low interest rates in achieving a nominal surplus.

Table 3.1: State budget

				growth in EUR million		growth in %		contribution to growth in p.p	
	2017	2018	2019*	2018	2019*	2018	2019*	2018	2019*
Total revenues	**8,830**	**10,000**	**10,354**	**1,170**	**353**	**13.3**	**3.5**	**13.3**	**3.5**
Personal income tax	1,100	1,280	1,409	180	129	16.4	10.1	2.0	1.3
Corporation tax	766	846	900	79	54	10.4	6.4	0.9	0.5
Value added tax	3,504	3,757	3,949	253	192	7.2	5.1	2.9	1.9
Excise duties	1,585	1,560	1,543	-26	-16	-1.6	-1.1	-0.3	-0.2
Non-tax revenues	671	867	593	196	-273	29.2	-31.5	2.2	-2.7
Receipts from the EU budget	395	794	1,018	399	224	101.0	28.2	4.5	2.2
Other	808	897	941	89	44	11.0	4.9	1.0	0.4
Total expenditures	**9,156**	**9,464**	**10,160**	**307**	**697**	**3.4**	**7.4**	**3.4**	**7.4**
Salaries, wages and other personnel expenditures	1,000	1,038	1,118	38	80	3.8	7.7	0.4	0.8
Expenditure on goods and services	728	785	845	57	60	7.8	7.7	0.6	0.6
Transfers to individuals and households	1,261	1,304	1,340	43	36	3.4	2.8	0.5	0.4
Interest payments	977	861	785	-117	-76	-11.9	-8.8	-1.3	-0.8
Subsidies	380	396	504	15	108	4.0	27.2	0.2	1.1
Capital expenditure and transfers	605	822	1,079	217	257	35.8	31.3	2.4	2.7
Current transfers to social security funds	1,226	1,145	1,110	-81	-35	-6.6	-3.0	-0.9	-0.4
Current transfers to other government insitutions	1,953	1,917	2,084	-36	166	-1.8	8.7	-0.4	1.8
Other	1,026	1,197	1,296	171	99	16.7	8.3	1.9	1.0
Balance	**-326**	**537**	**194**	**863**	**-343**				

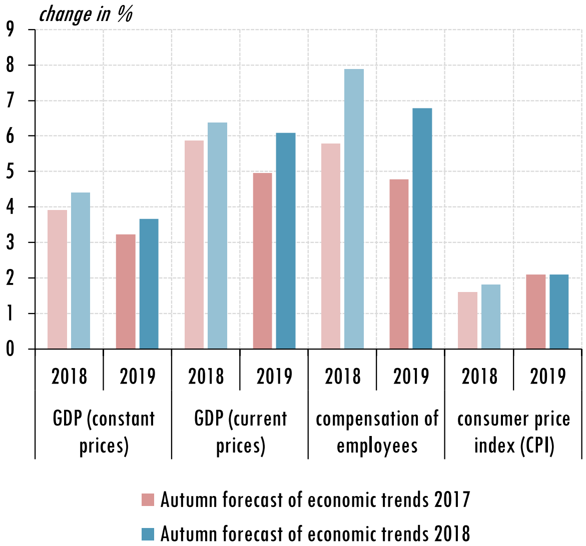
*Sources: Ministry of Finance, FC calculations. Note: *Proposal of revised state budget 2019 (January 2019).*

[12] Salaries and other compensation of employees and current transfers to public institutes for salaries and other compensation of employees.

4. Comparison between the proposal of revised budget and the budget adopted for 2019

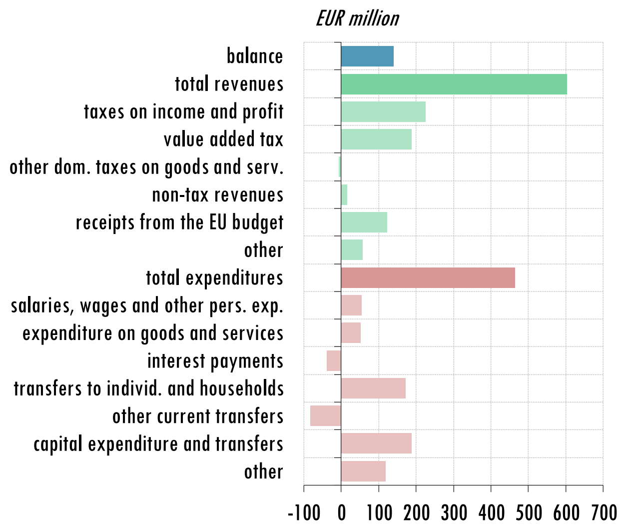
The proposal of revised budget envisages for 2019 a higher state budget surplus than envisaged by the budget adopted in the autumn of 2017, which is principally the result of a higher projection of revenue and better macroeconomic base levels The budget which was adopted for 2019 and approved by the National Assembly in November 2017 was based on IMAD's autumn forecast for 2017, which was less favourable than that from autumn 2018 which serves as the basis for the proposed revised budget (Figure 4.1). More favourable macroeconomic base levels on which a proposal of revised budget was based resulted in a considerably higher projected revenues by approximately EUR 600 million. Almost two-thirds of the projected increase is due to higher tax revenues and higher drawdown of EU funds. Projected expenditures are higher by approximately EUR 500 million. The bulk of the increase is the result of higher than foreseen expenditure on investments, partly also in conjunction with more optimistic assumptions of drawdown of EU funds, and transfers to individuals and households resulting from the loosening of austerity measures and the adoption of new measures on social transfers. The projected labour cost expenditures and intermediate consumption expenditures are also higher than those envisaged by the adopted budget.

Figure 4.1: Macroeconomic aggregates growth forecasts for 2018 and 2019



Source: IMAD, FC calculations.

Figure 4.2: The difference between the proposal of revised budget and the adopted budget 2019



Source: MoF, Adopted state budget RS 2019 (Nov. 17) in Proposal of revised state budget RS 2019 (Jan. 19).

5. Macroeconomic and fiscal risks

Risks to the macroeconomic scenario, which serves as the basis for budget documents and the proposal of revised state budget for 2019, are on a down side and mainly arise from the international environment. The macroeconomic scenario, which serves as the basis for budget documents, originates from IMAD's autumn forecast from last year, which predicted a further slowdown of economic growth from 4.4% anticipated for 2018 to 3.7% this year. The projected economic trends should nevertheless remain favourable and positively impact tax bases.[13] After the publication of IMAD's forecast, international institutions began lowering their forecasts for this year's economic growth in Slovenia's major trading partners due to poorer than expected results at the end of last year and increased uncertainty. Uncertainty is associated primarily with the possible aggravation of trade disputes, deterioration of the situation in financial markets, a considerable slowdown in China's economic activity, and due to the political situation in major global economies (uncertainties regarding the functioning of the U.S. government agencies, Brexit, the situation in Italy and France). This uncertainty is currently particularly reflected in lower economic sentiment indicators and expectations. A considerable deterioration in the international situation could have serious consequences for a small and open economy like Slovenia.[14] In addition to a direct negative impact on exports, it could also result in the postponement of decisions on consumption, i.e. on lower investment and lower final consumption. The increase in household consumption could thus be slower than forecast, which, according to the currently available data, occurred already last year and represents an additional risk to fiscal projections. Moreover, the ECB has not yet changed its intentions regarding the gradual normalisation of the monetary policy, which could result in higher interest rates and consequently increase the costs of financing, including of the still high public debt.

[13] The increase in nominal GDP and compensation of employees should be slightly lower than last year, but still considerably higher than in the period 2014-2016.

[14] The last available forecast was prepared by the International Monetary Fund (IMF), which considerably lowered the forecast of this year's economic growth for Germany and Italy, which are Slovenia's major trading partners.